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No. 664

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1952

NATIONAL FRUIT PRODUCT COMPANY, INCORPORATED,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

---

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Dated March 17, 1953

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Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

National Fruit Product Company, Incorporated, respectfully prays that a writ of certiorari issue to review a judgment of the United States Court of Appeals for the Fourth Circuit. The judgment affirmed an order of the United States District Court for the Western District of Virginia, at Harrisonburg, entered May 26, 1952 (R. 28), denying Petitioner a refund of excess profits tax for its taxable year ended June 30, 1946.

OPINIONS BELOW

The opinion of the District Court is reported in 105 F. Supp. 658.

The *per curiam* opinion of the Court of Appeals is reported in 199 F. (2d) 754.

JURISDICTION

The judgment of the Court of Appeals was entered on November 10, 1952. A petition for rehearing, seasonably filed, was denied on December 18, 1952. The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

STATUTES INVOLVED

Pertinent portions of the Internal Revenue Code and of the Revenue Act of 1945 are copied in the Appendix.

QUESTION PRESENTED

For the year ended June 30, 1948, after expiration of the World War II excess profits tax and termination of the privilege of carrying back an unused excess profits credit, the

Petitioner sustained a net operating loss that was carried back to the year ended June 30, 1946. In that year the excess profits credit was computed under the invested capital method, but in fiscal 1948, when the net operating loss was incurred, no excess profits credit was computed because the excess profits tax has been repealed. Was the Commissioner of Internal Revenue authorized, in determining the excess profits tax liability for fiscal 1946,[1] in reducing the net operating loss carry-back from fiscal 1948 by one-half of the interest accrued on notes outstanding in fiscal 1948 although the statute required that reduction only if the excess profits credit for fiscal 1948 was computed on the invested capital method and no credit was computed; and, in addition, if such a credit were to be computed, it should properly be computed on the income method?

As the Court of Appeals recognized, fairness requires a negative answer to this question; the words of the statute lead to a negative answer; the decisions below to the contrary are erroneous and the orderly administration of the revenue laws requires their reversal.

STATEMENT

Petitioner sustained a net loss from operations for its 1948 fiscal year. One of the deductions making up that loss was $106,564.66, representing interest on outstanding notes. Petitioner seasonably filed a claim for refund of fiscal 1946 income and excess profits taxes previously paid for that year. The basis for the refund claim was that the fiscal 1948 net operating loss constituted, after adjustments not here

[1] When we speak of fiscal 1946, we speak of the year ended June 30, 1946, and thus a taxable year subject in part to the excess profits tax since it began before December 31, 1945, the effective date of the repeal of the excess profits tax (Revenue Act of 1945, § 122(a)).

in question, a net operating loss deduction for fiscal 1946, the second year preceding the loss.

The Commissioner of Internal Revenue, in determining the excess profits tax refund, reduced the net operating loss deduction for fiscal 1946 by $53,282.33, representing one-half the interest accruing in fiscal 1948 on outstanding notes. Refunds or credits of fiscal 1946 income and excess profits taxes, the latter computed by taking into account only the reduced net operating loss deduction, have been received by Petitioner and are not in question. The only issue involved in the controversy, and the basis for the suit in the District Court, is whether the Commissioner was authorized to reduce the net operating loss deduction by the $53,282.33.

The excess profits credit of Petitioner for fiscal 1946 was computed under §714,[2] providing for the invested capital method.

SUMMARY OF ARGUMENT

1. The reduction of the fiscal 1948 net operating loss by one-half the interest accrued on notes then outstanding, for purposes of determining the fiscal 1946 net operating loss deduction, is required only if the fiscal 1948 excess profits credit "was computed" under the invested capital method. Since there was not any excess profits tax for fiscal 1948 and the credit for that year was not computed under the invested capital, income or any other method, the adjustment is not required.

2. Even if, as held by the Court below, the statute requires the computation of a "theoretical" excess profits credit for fiscal 1948, the adjustment is not required. This

[2] All references to statutes will be to the Internal Revenue Code unless otherwise specified.

is true because of §712 which requires that the credit be computed on the income method or the invested capital method, whichever results in the lesser tax for the taxable year in respect of which the tax is being computed. This year cannot be fiscal 1948 but must be fiscal 1946; the use of the income method of computing the credit would result in the lesser tax for fiscal 1946; and when the income method is used the adjustment for interest is not required.

ARGUMENT

1. The Interest Adjustment Is Not Required Because an Excess Profits Credit Was Not Computed for Fiscal 1948 Under the Invested Capital Method.

As its name implies, the excess profits tax of World War II was designed to subject to tax, at very high rates, only those profits that were excessive. In determining what might be considered as normal profits, exempt from the tax, Congress allowed all taxpayers to compute an excess profits credit, the amount of which was deducted from excess profits net income in determining the profits subject to tax. The excess profits credit could be determined by using a percentage of average income earned during the base period years 1936-1939, provided by §713, or by using a percentage of invested capital, provided by §714. Section 712(a) required taxpayers to compute the excess profits credit under §713 or §714, "whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed".

Section 711(a) provided for the general rule that the excess profits net income, from which the credit was deducted in determining the income subject to tax, is the "normal-tax net income" with certain adjustments. Normal tax net income is a concept of Chapter I of the Code dealing with the income tax, and for our purposes the term is

equivalent to "net income"—gross income minus the deductions allowed by the statute. Thus the starting point for determining excess profits net income is the net income computed for income tax purposes.

The first computation, therefore, has reduced gross income by all the deductions allowed by §23. One of those deductions is the net operating loss deduction, allowed by §23(s), and that deduction is defined in and computed pursuant to the provisions of §122. The net operating loss deduction, just as the deductions for business expenses, wages, rent and interest, is allowed in determining net income whether or not an excess profits tax is in effect.

For fiscal 1946 the taxpayer computed its excess profits credit pursuant to the invested capital method provided by §714. For taxpayers using that method of computing the credit, §711(a)(2) required certain adjustments to normal tax net income in arriving at excess profits net income. One of those adjustments, contained in §711(a)(2)(B), was that interest on borrowed capital should not be deducted in full as in the determination of normal tax net income but only to the extent of 50%. The reason for this was that 50% of borrowed capital (indebtedness represented by certain credit instruments such as bonds and notes, specified in §719) was included in the invested capital base used to determine the excess profits credit by this method. This same scheme is followed in the present excess profits tax except that the present statute allows 75% of such indebtedness to be included in the base of the credit computation and disallows 75% of the interest paid on such indebtedness as a deduction. §§437(b)(2)(C) and 433(a)(1)(N)

Somewhat similar adjustments were required in respect of operating loss carry-backs.[3] In determining the amount of the net operating loss deduction (for the taxable year),

[3] See §711(a)(2)(L)(i) and §711(a)(1)(J)(i).

the statute required that the net operating loss (for the year of the loss) must be reduced by 50% of the interest on borrowed capital if the excess profits credit for the loss year "was computed" under the invested capital method.

Petitioner made the interest adjustment as to interest accrued in fiscal 1946 in determining its excess profits net income for fiscal 1946. That is the adjustment required by §711(a)(2)(B) [discussed in the second paragraph above] and it is not in question here. What is in question is whether an interest adjustment is required for fiscal 1948 in determining the amount of the 1948 loss that may be carried back to fiscal 1946. That is the matter referred to in the next preceding paragraph. The purpose of those provisions is important for it is determinative of the issue presented here. If a taxpayer has a net operating loss there also will be an unused credit, which also may be carried back (§710(c)), and if the credit for carry-back purposes is computed under the invested capital method (obtaining the advantage of 50% of borrowed capital) the interest adjustment should be made to the operating loss. Only in this manner can the carry-back of both loss and credit be accomplished with fairness to both parties.

The repeal of the excess profits tax by §122(a) of the Revenue Act of 1945, for taxable years beginning after December 31, 1945, was fully effective for fiscal 1948, although the tax remained "in force for the purposes of the determination of the taxes imposed" for fiscal 1946 (*id.*, §122(b)). The adjustment to the fiscal 1948 net operating loss is required by the statute only "if the excess profits credit for such taxable year [fiscal 1948] *was computed* under section 714" (§711(a)(2)(L)(i)). But no excess profits credit at all was computed for fiscal 1948. The tax for that year was not in existence. Since no excess profits credit was computed for fiscal 1948, it could not have been computed under §714 or §713 or any other section, and the condition

precedent to the requirement for the interest adjustment is not satisfied.

The Court below, although admitting the equity of the Petitioner's contention, thought the concluding words of § 122 (b) of the Revenue Act of 1945 that the determination of fiscal 1946 taxes is "to be made as if subsection (a) [the repealing section] had not been enacted . . ." put upon the taxpayer the burden of showing that its "theoretical excess profits credit" for fiscal 1948 "was not properly computed". If the excess profits tax had been in effect in fiscal 1948, no doubt the taxpayer would have computed an excess profits credit. It is entirely irrelevant, however, to speak of how the excess profits credit "would have been computed" when, in fact, the excess profits tax (and all related provisions of the statute including the definition of the excess profits credit) had been repealed for all purposes so far as fiscal 1948 is concerned.

A would-be computation of the excess profits credit for fiscal 1948 is not the statutory test. Section 711(a)(2)(L)(i) requires the interest adjustment only if the credit for that year *was computed* under § 714. No credit was computed for that year, either by the taxpayer, by the United States or by anyone else. Where none was computed, the adjustment is not required.

2. If the Words "Was Computed" Must Be Read "Would Have Been Computed", the Proper Computation Would Be Pursuant to the Income Method and No Adjustment for Interest Is Authorized.

Let us assume that the excess profits tax provisions remained in effect for fiscal 1948,[4] though they did not. As we

[4] For this purpose, however, we must eliminate the provisions relating to the carry-back of an unused excess profits credit, for this is specifically required by § 122(c) of the Revenue Act of 1945.

have seen, the net operating loss deduction adjustment for fiscal 1946 is to be made only if the excess profits credit for fiscal 1948 "was computed under section 714" (§711(a)(2)(L)(i)). The credit for fiscal 1948 is required to be computed under the invested capital method (§714) or the income method (§713), "whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed" (§712).

In fiscal 1948 the Petitioner did not have any income subject to tax, excess profits or otherwise. It sustained a net loss in that year. Accordingly, had the excess profits tax then been in effect, no excess profits tax would have been payable in respect of fiscal 1948. The computation of the excess profits credit, whether made under §714 or §713 (or if not made at all), would result in a tax liability of zero, and neither credit computation results in a "lesser" excess profits tax for fiscal 1948 than the other. Accordingly, fiscal 1948 cannot be "the taxable year" in respect of which the excess profits tax "is being computed" (§712 above).

The only other "taxable year for which the tax under this subchapter is being computed" is fiscal 1946. Under the facts applicable to the Petitioner as shown from the record here, if a theoretical excess profits credit for fiscal 1948 is to be computed, it must be computed under the income method provided by §713, for, as the United States admits, computation under that section rather than under §714 "results in the lesser tax under this subchapter for the taxable year [fiscal 1946] for which the tax under this subchapter is being computed" (§712 above).

Since the theoretical excess profits credit for fiscal 1948, if one is required, must be computed under §713, the adjustment for interest to the net operating loss carry-back is

not required. The decision of the Court below is equally wrong on this analysis.

REASONS FOR GRANTING THE WRIT

1. General Importance of the Question

The importance of an orderly administration and uniform application of the revenue laws of the United States does not need to be emphasized. The objective of a uniform application of the revenue laws, as this Court has pointed out,[5] is accomplished largely by the function of the Tax Court of the United States, and perhaps it is unfortunate for the Petitioner here that the Tax Court did not have jurisdiction to consider this case. That resulted from the fact that the fiscal 1948 net operating loss resulted in an overpayment rather than a deficiency for fiscal 1946.

In cases, such as this, of great complexity involving a maze of interrelated statutory provisions the lower Federal courts should be instructed whenever possible by this Court. Until the question is settled the Commissioner will continue to take conflicting positions.[6] Furthermore, since the same statutory provisions are contained in the current excess profits tax statutes,[7] a decision here will be determinative of questions arising not only under the World War II law but also under the present law.

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[5] See, for example, *Dobson* v. *Commissioner*, 320 U. S. 489 (1944).

[6] It was admitted in the brief for the United States in the Court below that it had made a contrary argument, which was sustained, in *Aluminum Products Co.* v. *United States*, 101 F. Supp. 373 (Ct. Cls., 1951), although that case was said to be distinguishable. The Commissioner has not promulgated regulations that govern the issue in this case.

[7] Internal Revenue Code, § 433(a)(1)(J).

2. Decisions of Other Courts

On the precise issue involved, this is a case of first impression. Thus, although the Petitioner has been advised of other cases in the process of litigation, there are no other decisions directly conflicting with the decision of the Court below.

The Court of Claims has decided two cases involving the carry-back of unused excess profits credit or of a net operating loss for excess profits tax purposes that appear to conflict in principle with the decision of the Court below.[8]

CONCLUSION

The Petitioner submits, therefore, that this case presents a matter of substantial importance in the administration of the revenue laws which should properly be determined by this Court.

The Petitioner, accordingly, prays that a writ of certiorari issue to bring before this Court for review the judgment of the Court below.

Dated March 17, 1953.

Respectfully submitted,

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[8] *Aluminum Products Co.* v. *United States*, *supra*, note 6; *Olympic Radio and Television, Inc.* v. *United States*, 108 F. Supp. 109 (1952), *id.*, 53-1 USTC ¶9233 (March 3, 1953).

Internal Revenue Code

Section 23. Deductions From Gross Income.

In computing net income there shall be allowed as deductions:

* * *

(s) *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

Section 122. Net Operating Loss Deduction.

(a) *Definition of Net Operating Loss.*—As used in this section, the term 'net operating loss' means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) *Amount of Carry-back and Carry-over.*—

(1) *Net Operating Loss Carry-back.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding years except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

* * *

(c) *Amount of Net Operating Loss Deduction.*—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d), (1), (2), (3), and (4) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credit provided in section 26(e)).

Section 711. Excess Profits Net Income.

(a) *Taxable Years Beginning After December 31, 1939.*—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13(a)(2), for such year except that the following adjustments shall be made:

(1) *Excess Profits Credit Computed Under Income Credit.*—If the excess profits credit is computed under section 713, the adjustments shall be as follows:

* * *

(J) *Net Operating Loss Deduction Adjustment.*—The net operating loss deduction shall be adjusted as follows:

(i) In computing the net operating loss for any taxable year under section 122(a), and the net income for any taxable year under section 122(b), no deduction shall be allowed for any excess profits

tax imposed by this subchapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall be reduced by the amount of any reduction under paragraph (2) (B) for such taxable year; and

* * *

(2) *Excess Profits Credit Computed Under Invested Capital Credit.*—If the excess profits credit is computed under section 714, the adjustments shall be as follows:

* * *

(B) *Interest.*—The deduction for interest shall be reduced by an amount equal to 50 per centum of so much of such interest as represents interest on the indebtedness included in the daily amounts of borrowed capital (determined under section 719 (a));

* * *

(L) *Net Operating Loss Deduction Adjustment.*—The net operating loss deduction shall be adjusted as follows:

(i) In computing the net operating loss for any taxable year under section 122(a), and the net income for any taxable year under section 122(b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall be reduced by the amount of any reduction under subparagraph (B) of this paragraph for such taxable year; and

Section 712. Excess Profits Credit—Allowance.

(a) *Domestic Corporations.*—In the case of a domestic corporation which was in existence before January 1, 1940, the excess profits credit for any taxable year shall be an amount computed under section 713 or section 714, whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed.* * *

Revenue Act of 1945

Section 122. *Repeal of Excess Profits Tax in 1946.*

(a) *In General.*—The provisions of subchapter E of chapter 2 [providing for the excess profits tax] shall not apply to any taxable year beginning after December 31, 1945.

(b) *Carry-backs from Years After 1945, etc.*—Despite the provisions of subsection (a) of this section the provisions of subchapter E of chapter 2 shall remain in force for the purposes of the determination of the taxes imposed by such subchapter for taxable years beginning before January 1, 1946, such determination to be made as if subsection (a) had not been enacted but with the application of the amendments made by subsection (c) of this section and section 131 of this Act.

(c) *Unused Excess Profits Credit for Taxable Year Beginning After December 31, 1945.*—Section 710(c)(2) (defining the unused excess profits credit) is amended by inserting at the end thereof a new sentence reading as follows: "There shall be no unused excess profits credit for a taxable year beginning after December 31, 1946. The unused excess profits credit for a

taxable year beginning in 1946 and ending in 1947 shall be an amount which is such part of the unused excess profits credit determined under the preceding provisions of this paragraph as the number of days in such taxable year prior to January 1, 1947, is of the total number of days in such taxable year.

Section 131. *Fiscal Year Taxpayers.*

* * *

(b) *Excess Profits Tax.*—

(1) *In General.*—Section 710(a) (imposing the excess profits tax) is amended by inserting at the end thereof the following:

"(7) *Taxable Years Beginning in 1945 and Ending in 1946.*—In the case of a taxable year beginning in 1945 and ending in 1946, the tax shall be an amount equal to that portion of a tentative tax, computed as if the law applicable to taxable years beginning on January 1, 1945, were applicable to such taxable year, which the number of days in such taxable year prior to January 1, 1946, bears to the total number of days in such taxable year."

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In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 664

NATIONAL FRUIT PRODUCT COMPANY, INCORPORATED,
Petitioner

v.

UNITED STATES OF AMERICA

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The *per curiam* opinion of the Court of Appeals (R. 30-31) is reported at 199 F. 2d 754. The opinion of the District Court (R. 19-27) is reported at 105 F. Supp. 658.

JURISDICTION

The judgment of the Court of Appeals was entered on November 10, 1952. (R. 32.) A petition

for rehearing (R. 33-39), timely filed by National Fruit Product Company on December 9, 1952, was denied without opinion on December 18, 1952 (R. 40). The petition for a writ of certiorari was filed on March 17, 1953. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the Court of Appeals erred in holding that, in computing the taxpayer's net operating loss deduction for the fiscal year 1946 for excess profits tax purposes, the net operating loss for the fiscal year 1948 and the resulting net operating loss carry-back to the fiscal year 1946 should be reduced by 50% of the interest paid or accrued in the fiscal year 1948 on borrowed capital, under the provisions of Section 711(a)(2)(L) of the Internal Revenue Code.

STATUTES INVOLVED

These will be found in the Appendix, *infra*, pp. 10-17.

STATEMENT

A stipulation of facts (R. 15-19) was filed, with no additional evidence being offered. The facts may be summarized as follows:

Petitioner is the successor in interest to the taxpayer, a Virginia corporation which kept its books on an accrual basis with its fiscal year ending on June 30th. (R. 15-16.)

Taxpayer filed its income and excess profits tax returns for the fiscal year 1946, and computed its excess profits credit for that year pursuant to the provisions of Section 714 of the Internal Revenue Code, providing for an excess profits credit based on invested capital. The resulting tax liability was duly paid. (R. 16-17, 18-19.)

Taxpayer's income tax return for the fiscal year 1948 showed a net loss of $209,331.46, based partly on an interest deduction of $142,643.17. Of this latter amount, $106,564.66 represented interest on outstanding indebtedness of taxpayer within the definition of borrowed capital set forth in Section 719(a)(1) of the Internal Revenue Code. (R. 17.) Taxpayer duly filed a claim for a refund of taxes paid for the year 1946, based on a carry-back of the net loss sustained in 1948. (R. 17-18.)

A portion of this claim was adjusted and allowed and is not now in controversy. However, the Commissioner of Internal Revenue, in his final determination of excess profits tax liability for 1946, reduced the net operating loss for 1948 and the resulting net operating loss carry-back to 1946 by the amount of $53,282.33, representing 50% of the interest on outstanding indebtedness within the definition of borrowed invested capital contained in Section 719(a)(1) of the Internal Revenue Code. (R. 18.) The District Court upheld this reduction of the net operating loss deduction for 1946. (R. 19-27.) The Court of Appeals affirmed in a *per*

curiam opinion (R. 30-31) and denied a rehearing without an opinion (R. 40).

ARGUMENT

This case presents no question calling for review by this Court. As the taxpayer specifically recognizes (Pet. 10), no conflict of decisions is involved; nor do we believe that the Commissioner has taken conflicting positions.[1] And the question in the case has only a limited importance, since the excess profits tax provisions of the Code, Section 711 (a)(2)(L)(i) (Appendix, *infra*, p. 14) of which is involved here, were repealed effective with taxable years beginning after December 31, 1945, by Section 122 of the Revenue Act of 1945 (Appendix, *infra*, pp. 16-17), except that they remained in

[1] The taxpayer cautiously mentions two cases, which he says "appear to conflict in principle." (Pet. 10) These are so clearly distinguishable as to warrant a minimum of discussion here. In *Aluminum Products Co.* v. *United States*, 101 F. Supp. 373 (C. Cls.), the taxpayer in 1946 was a personal holding company under Section 501 and its income was personal holding company income under Section 502; therefore, by Section 727 (e) of the Code, it was not subject to the provisions of the excess profits tax law, even though it had been subject to the tax in 1944, the year to which the carry-back was claimed. In *Olympic Radio & Television* v. *United States*, 108 F. Supp. 109 (C. Cls.), rehearing denied March 3, 1953, with opinion (1953 C.C.H., par. 9233), the issue involved the deduction and carry-back of excess profits taxes on 1945 profits, which were not paid until 1946, the year of the net operating loss. Cf. *Lewyt Corp.* v. *Commissioner*, 18 T.C. 1245. Neither case has any bearing on the instant case, nor was the Commissioner's position in those cases inconsistent with his position here.

force for purposes of determining carry-backs from years after 1945, such carry-backs being allowable from the two subsequent years only.[2] Moreover, the decision below is clearly correct.

The provisions of the excess profits tax law (subchapter E of Chapter 2 of the Code) were applicable to the fiscal year 1946 involved here. By virtue of Section 122 (a) and (b) of the Revenue Act of 1945 (Appendix, *infra*, p. 16), the provisions imposing the excess profits tax were not in effect in 1948, except that they remained in full force and effect for the purpose of determining carry-backs in computing the excess profits tax for certain earlier years, including the fiscal year ended June 30, 1946, "as if the excess profits tax had not been repealed" (R. 24). Thus, as both lower courts correctly held (R. 19-27, 30-31), Section 711 (a)(2)(L) of the Internal Revenue Code, dealing with carry-backs, requires by its very terms that the amount of the taxpayer's net operating loss deduction for its fiscal year 1946 under Code Sections 23 (s) and 122, resulting from the carry-back of its net operating loss for the fiscal year 1948, be reduced by $53,282.33, representing one-half of the

[2] Taxpayer's assertion that this case will determine questions arising under the present excess profits tax statutes (Pet. 9) is not believed to be correct. The question here arises only because of the 1945 repealing provisions which continued the former excess profits law in effect to determine carry-backs from two later years, and the current law has not yet been repealed with the particular proviso involved here, nor is it presently predictable that it will be.

interest paid or accrued in 1948 on outstanding indebtedness constituting borrowed capital of the taxpayer. Cf. *Reo Motors* v. *Commissioner,* 338 U.S. 442, 446-447, 450.

That such is the intent and effect of Section 122 (b) of the Revenue Act of 1945 is perfectly clear from the statutory language itself (*infra,* p. 16), and H. Conference Rep. No. 1165, 79th Cong., 1st Sess., p. 7 (1945 Cum. Bull. 654, 655), confirms this fully when it states:

> * * * despite the repeal of the excess-profits tax for 1946, the provisions of the excess-profits-tax law shall remain in force * * * so as to assure the making of the necessary adjustments in the net operating loss carry-backs.

The taxpayer's contrary argument (Pet. 4-9) was correctly and summarily rejected by the Court of Appeals (R. 30-31). Its contention appears to be that even if Section 711 (a) (2) (L) of the excess profits law remained in effect after 1946 for carry-back purposes, still that section would not require reduction of the operating loss by 50 percent of the interest on outstanding indebtedness constituting borrowed capital in computing the deduction for 1946 arising out of the carry-back from 1948, because taxpayer did not actually compute an excess profits credit for the year 1948 at all, and thus had no occasion to compute an excess profits credit for 1948 under the special formula set forth in Sec-

tions 711(a)(2)(L)(i) and 714. It is true that the taxpayer was not subject to an excess profits tax in 1948, because the tax had been terminated by Congress, and thus the taxpayer did not compute an excess profits credit in 1948 under Section 714, or compute its borrowed capital under Section 719 for the purpose of determining any excess profits tax liability in that year. But it does not follow that Section 711 (a)(2)(L)(i) does not apply to it so far as the carry-back to 1946 is concerned. Subparagraph (L) was added in 1942 and when enacted was, of course, phrased with the thought that there would be excess profits tax liability for both of the years with which it dealt, rather than that there would be no liability for the tax in the later year. In providing in Section 122 (b) of the 1945 Act, the repealing statute, that the section should remain in effect to assure making the necessary adjustments in the net operating loss carry-back, Congress obviously did not intend or contemplate that an excess profits credit and borrowed capital would actually be computed as a step in determining excess profits tax liability for 1948, since the tax was being repealed for that year. Rather, Section 711 (a)(2)(L) was continued in effect under the assumption and intention that the excess profits credit and borrowed capital would be determined for the purpose of computing a carry-back to earlier years, just as if the tax had not been repealed. Any other construction would rob Section 122 (b) of the 1945 Act

of any effect or application insofar as Section 711 (a)(2)(L) is concerned.

It remains only to point out that the record contains nothing to show that the theoretical excess profits credit in 1948 was not properly computed under Section 714, *i.e.*, under the invested capital method, or that the Commissioner did not so determine in denying the claim for refund to the extent in issue here. On the contrary, in the absence of a showing by the taxpayer that use of the average earnings method for the fiscal year 1948 would have given it a larger excess profits credit for that year, it must be assumed that, since the taxpayer computed its excess profits credit for the fiscal year 1946 under the invested capital method (R. 18-19), it would continue to compute it for 1948 under the same method. In the absence of proof, it must be taken that the average earnings of the base period as prescribed by Section 713 of the Code (26 U.S.C. 1946 ed., Sec. 713) were too low to be taken as a measure of normal profits. This assumption is reinforced by the fact that the year 1947 was a year of generally good business activity and profits, and under Section 718 of the Internal Revenue Code (26 U.S.C. 1946 ed., Sec. 718), additional earnings and profits not distributed would add to the invested capital base on which the excess profits credit would be computed. We have no facts in the record to indicate that the taxpayer had a loss in the fiscal year 1947. Since the taxpayer has not sustained its burden of proving the contrary, the

record supports only the inference that the Commissioner properly computed the excess profits credit in 1948 on the invested capital method, as a step in determining the allowable loss carry-back to 1946.

CONCLUSION

The decision below is correct. There is no conflict in the decisions. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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APRIL, 1953.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(s) [as added by Sec. 211 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

SEC. 122 [as added by Sec. 211 (b) of the Revenue Act of 1939, *supra,* and amended by Secs. 105 (e) and 153 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. NET OPERATING LOSS DEDUCTION.

(a) *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) *Amount of Carry-Back and Carry-Over.*—

(1) *Net operating loss carry-back.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss,

such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

* * * * *

(c) *Amount of Net Operating Loss Deduction.*—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and (4)), exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credit provided in section 26 (e)).

* * * * *

(26 U. S. C. 1946 ed., Sec. 122.)

SEC. 710 [as added by Sec. 201, Second Revenue Act of 1940, c. 757, 54 Stat. 974]. IMPOSITION OF TAX.

* * * * *

(c) [as added by Sec. 2 (b), Excess Profits Tax Amendments of 1941, c. 10, 55 Stat. 17, and amended by Sec. 204 (b), Revenue Act of 1942, *supra*] *Unused Excess Profits Credit Adjustment.*—

* * * * *

(2) *Definition of unused excess profits credit.*—The term "unused excess profits credit" means the excess, if any, of the excess profits credit for any taxable year beginning after December 31, 1939, over the excess profits net income for such taxable year, computed on the basis of the excess profits credit applicable to such taxable year. For such purpose the excess profits credit and the excess profits net income for any taxable year beginning in 1940 shall be computed under the law applicable to taxable years beginning in 1941. The unused excess profits credit for a taxable year of less than twelve months shall be an amount which is such part of the unused excess profits credit determined under the first sentence of this paragraph as the number of days in the taxable year is of the number of days in the twelve months ending with the close of the taxable year.

* * * * *

(26 U. S. C., 1946 ed., Sec. 710.)

SEC. 711 [as added by Sec. 201, Second Revenue Act of 1940, *supra*]. EXCESS PROFITS NET INCOME.

(a) *Taxable Years Beginning After December 31, 1939.*—The excess profits net income for

any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13 (a) (2), for such year except that the following adjustments shall be made;

(1) *Excess profits credit computed under income credit.*—If the excess profits credit is computed under section 713, the adjustments shall be as follows:

* * * * *

(J) [as added by Sec. 210 (a), Revenue Act of 1942, *supra*] *Net Operating Loss Deduction Adjustment.*—The net operating loss deduction shall be adjusted as follows:

(i) In computing the net operating loss for any taxable year under section 122 (a), and the net income for any taxable year under section 122 (b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall be reduced by the amount of any reduction under paragraph (2) (B) for such taxable year; and

(ii) In lieu of the reduction provided in section 122 (c), such reduction shall be in the amount by which the excess profits net income computed with the exceptions and limitations specified in section 122 (d) (1), (2), (3), and (4) and computed without regard to subparagraph (B), without regard to any credit for dividends received, and without regard to any

credit for interest received provided in section 26 (a) exceeds the excess profits net income (computed without the net operating loss deduction).

(2) *Excess profits credit computed under invested capital credit.*—If the excess profits credit is computed under section 714, the adjustments shall be as follows:

* * * * *

(B) *Interest.*—The deduction for interest shall be reduced by an amount equal to 50 per centum of so much of such interest as represents interest on the indebtedness included in the daily amounts of borrowed capital (determined under section 719 (a));

* * * * *

(L) [as added by Sec. 210 (b) of the Revenue Act of 1942, *supra*] *Net Operating Loss Deduction Adjustment.*—The net operating loss deduction shall be adjusted as follows:

(i) In computing the net operating loss for any taxable year under section 122 (a), and the net income for any taxable year under section 122 (b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall be reduced by the amount of any reduction under subparagraph (B) of this paragraph for such taxable year; and

(ii) In lieu of the reduction provided in section 122 (c), such reduction shall be in the amount by which the excess profits net income computed with the exceptions and limitations provided in section 122 (d) (1), (2), (3), and (4) and computed without regard to subparagraph (D), without regard to any credit for dividends received, and without regard to any credit for interest received provided in section 26(a) exceeds the excess profits net income (computed without the net operating loss deduction).

* * * * *

(26 U. S. C. 1946 ed., Sec. 711.)

SEC. 712 [as added by Sec. 201 of the Second Revenue Act of 1940, *supra,* and amended by Sec. 13 of the Excess Profits Tax Amendment of 1941, *supra*]. EXCESS PROFITS CREDIT—ALLOWANCE

(a) *Domestic Corporations.*—In the case of a domestic corporation which was in existence before January 1, 1940, the excess profits credit for any taxable year shall be an amount computed under section 713 or section 714, whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed. In the case of all other domestic corporations the excess profits credit for any taxable year shall be an amount computed under section 714. (For allowance of excess

profits credit in case of certain reorganizations of corporations, see section 741.)

* * * * *

(26 U. S. C. 1946 ed., Sec. 712.)

Revenue Act of 1945, c. 453, 59 Stat. 556:

SEC. 122. REPEAL OF EXCESS PROFITS TAX IN 1946.

(a) *In General.*—The provisions of subchapter E of chapter 2 shall not apply to any taxable year beginning after December 31, 1945.

(b) *Carry-backs from Years After 1945, Etc.*—Despite the provisions of subsection (a) of this section the provisions of subchapter E of chapter 2 shall remain in force for the purposes of the determination of the taxes imposed by such subchapter for taxable years beginning before January 1, 1946, such determination to be made as if subsection (a) had not been enacted but with the application of the amendments made by subsection (c) of this section and section 131 of this Act.

(c) *Unused Excess Profits Credit for Taxable Year Beginning After December 31, 1945.*—Section 710(c)(2) (defining the unused excess profits credit) is amended by inserting at the end thereof a new sentence reading as follows: "There shall be no unused excess profits credit for a taxable year beginning after December 31, 1946. The unused excess profits credit for a taxable year beginning in 1946 and ending in 1947 shall be an amount

which is such part of the unused excess profits credit determined under the preceding provisions of this paragraph as the number of days in such taxable year prior to January 1, 1947, is of the total number of days in such taxable year."

* * * * *

SEC. 131. FISCAL YEAR TAXPAYERS.

* * * * *

(b) *Excess Profits Tax.*—

(1) *In general.*—Section 710 (a) (imposing the excess profits tax) is amended by inserting at the end thereof the following:

"(7) *Taxable years beginning in 1945 and ending in 1946.*—In the case of a taxable year beginning in 1945 and ending in 1946, the tax shall be an amount equal to that portion of a tentative tax, computed as if the law applicable to taxable years beginning on January 1, 1945, were applicable to such taxable year, which the number of days in such taxable year prior to January 1, 1946, bears to the total number of days in such taxable year."

* * * * *

(26 U. S. C. 1946 ed., Sec. 710.)

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